

Sales of "canned" computer software are considered taxable retail sales in Illinois regardless of the manner of the transfer of that software. See 86 Ill. Adm. Code 130.1935. (This is a GIL).

October 23, 2002

Dear Xxxxx:

This letter is in response to your letter dated July 3, 2002. We apologize for the delay in responding to your inquiry. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found on the Department's Internet website at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

Our client is an application software provider (ASP), which enables smaller financial institutions to offer Internet access to their customers. The customers of the financial institution can view their accounts, make transfers, and make loan applications all through their personal computer, a service typically called home banking. They are not sold any software or required to download any software to access their accounts. They simply log in to the financial institution's web site.

Our question is in regard to the possible sales taxability of the payments made by the financial institution to AAA. It is our belief that AAA is not required to collect and remit sales tax, due it being a service, to the Internet Tax Freedom Act and your applicable regulations. Under the laws of Illinois, pure services are not subject to sales tax. The true object of sales and use tax is to tax transactions involving the retail sales of tangible personal property. Illinois does require the service person to pay a service occupation tax on tangible personal property transferred as an incident to a sale of service by a serviceman. [ILCS Chapter 35 § 115/3; Ill Admin. Code 86 § 160.101]. Receipts from services as such are not taxable. The type of services which are reached by the service occupation tax are those in which tangible personal property is transferred to the buyer as an incident to a sale of service. The tax is on the selling price of the tangible personal property transferred.

AAA does not provide tangible personal products to the financial institution other than perhaps a one-time sale of a computer router.

In general, the process works as follows:

On a real time basis:

The customer of the financial institution logs into the web site created by AAA for the financial institution. He would request data relating to his

account. AAA's computers in STATE would immediately access the database maintained by the financial institution and extract the transactions requested by the customer sending them to him to view on his computer.

On a delayed (or batch process) basis:

On a daily basis after the close of business, the financial institution uploads a computer file of all of the accounts that have signed up for home banking. The information is stored on AAA's computers in LOCATION. When the customer of the financial institution logs in to the financial institution web site and requests access to his account, he is accessing the database forwarded from the financial institution to AAA.

The financial institution is billed for a monthly fee based on a minimum fixed fee and an additional fee for customers who sign up for the home banking service (whether they use the service or not). Additional services provided by AAA include home page design and implementation, bill payment options, tax preparation options, and marketing information. We believe that AAA is not required to collect or remit sales tax on the service charged to the financial institution and request your concurrence to that opinion.

If you agree that the service is not taxable for sales tax purposes, is it necessary to apply for a sales tax license?

If you have any questions, please contact me. Thank you very much for your assistance in this matter.

DEPARTMENT'S RESPONSE:

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See the enclosed copy of 86 Ill. Adm. Code 130.101. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. See the enclosed copy of 86 Ill. Adm. Code 150.101. If no tangible personal property is being transferred to your client's customers, then no Illinois Retailers' Occupation Tax and Use Tax would apply.

Based upon the limited information contained in your letter, we cannot determine if your client is transferring software to its customers (the financial institutions) in conjunction with providing its Internet banking services. Please note that sales of "canned" computer software are considered taxable retail sales in Illinois regardless of the manner of the transfer of that software (electronically for example). See the enclosed copy of 86 Ill. Adm. Code 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See subsection (c) of Section 130.1935.

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See subsection (c)(3) of Section 130.1935. If transactions for the licensing of computer software meet all of the criteria provided in (a)(1) of Section 130.1935,

neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under subsection (c) of Section 130.1935, they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software.

Assuming that the Internet banking services your client provides do not require the transfer of tangible personal property to the recipients of those services (either the financial institutions or the customers of the financial institutions), charges for such services are exempt if they are separately stated from the selling price of any canned software that may be transferred to the financial institutions. See subsection (b) of Section 130.1935. If such services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for those services are not subject to tax.

Illinois also imposes a Telecommunications Excise Tax on the act or privilege of originating or receiving intrastate or interstate telecommunications by persons in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers by such persons. See 35 ILCS 630/3 and 4. The tax imposed is collected from the taxpayer by a retailer maintaining a place of business in this State and remitted to the Department. The Telecommunications Excise Tax Act defines gross charges as including amounts paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by retailers. See the enclosed copy of 86 Ill. Adm. Code 495.100. As long as the Internet banking services provided by your client do not, as part of those services, charge customers for the line or other transmission charges, your client would not generally be considered to be a telecommunications retailer. See for example subsection (d) of Section 495.100.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.